Internal Revenue Service

memorandum

CC:TL-N-4001-91
Br2:LSMannix

date: APR 30 1991

to: Regional Counsel, Midwest CC:MW
Attn: Assistant Regional Counsel (Large Case)

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted]

This responds to a request for tax litigation advice submitted by Janet E. Kidd, Special Trial Attorney, dated February 20, 1991. This also confirms our oral response to this request given to Matthew Fritz, CC:OMA, who was previously assigned this case, on March 15, 1991. It is our understanding that, consistent with our oral advice, Mr. Fritz conceded this issue in a status report hearing before Judge [redacted] on [redacted].

ISSUE

Whether the Commissioner properly imposed an addition to tax under I.R.C. § 6655 for an alleged underpayment of estimated tax.

RECOMMENDATION

During the year at issue, the taxpayers fell under the exception in section 6655(d)(1) and, thus, were not subject to the penalty. Therefore, we recommend conceding this issue.

DISCUSSION

The taxable year at issue is [redacted]. During [redacted], section 6655 generally imposed a penalty on all corporations that failed to make pro rata quarterly estimated tax payments equal to at least [redacted]% of their tax liability as finally reported on their income tax return for that taxable year. Section 6655(d)(1) contained an exception to that penalty where a corporation made pro rata quarterly estimated payments of tax for a total amount no less than that corporation's tax liability for the preceding taxable year provided that the corporation filed a return showing a liability for the preceding taxable year and the preceding taxable year was a 12-month period. A return showing only investment tax credit recapture constitutes a return showing a tax liability for purposes of section 6655(d)(1). See LTR 83-12-011 (March 19, 1983); LTR 88-50-005 (October 28, 1988).

Section 6655(i) stated that the exception under section 6655(d)(1) only applied to corporations that were not "large corporations." Section 6655(i) defined a "large corporation" as any corporation (or its predecessor) that had taxable income of $1 million or more during any of the preceding 3 taxable periods.

Treas. Reg. § 1.1502-5(b)(1) states in part: "For the first two taxable years for which a group files consolidated returns, the group may compute the amount of the penalty (if any) under section 6655 on a consolidated basis...." Reg. § 1.1502-5(b)(2)(ii) states in part: "The tax and facts shown on the return for the preceding taxable year referred to in section 6655(d)(1) and (2) are, if a consolidated return was filed for that preceding year, such items shown on the consolidated return for that preceding year...."

Furthermore, for groups filing consolidated returns, the "large corporation" test under section 6655(i) is made on a consolidated basis, as if the group were one corporation, by tracing back to the preceding taxable periods of the group or the preceding taxable periods of the parent corporation if the group was not in existence for all 3 preceding taxable periods. See LTR 87-29-063 (July 24, 1987); Crestol, Hennessey & Rua, The Consolidated Tax Return ¶ 9.01[5][a][iii] (4th Ed. and 1991 Supp.). Furthermore, for purposes of the "large corporation" test, the taxable income of members of the group for periods before they were members of the group are not aggregated with the corresponding consolidated return period of the group or the corresponding taxable period of the parent. Id.

For taxable year [redacted], the taxpayers filed a consolidated return in which [redacted] was the common parent and [redacted] and [redacted] were first tier subsidiaries of [redacted]. Thus, the section 6655 penalty for the [redacted] taxable year of the taxpayers may be computed on a consolidated basis.

On [redacted], a series of transactions took place culminating in [redacted], the parent of [redacted], contributing the stock of [redacted] to [redacted]. This transaction was a reverse acquisition under Treas. Reg. § 1.1502-75(d)(3). The effect of a reverse acquisition is that the taxable year of the acquired group (or corporation), in this case [redacted], is deemed to continue and the taxable year of the acquiring group, in this case [redacted] and [redacted], is deemed to close on the date of the transaction. Reg. § 1.1502-75(d)(3)(v).

In addition, Treas. Reg. 1.1502-76(b)(1) provides that for the purpose of determining the income to be included in the

consolidated return after the reverse acquisition (if the acquired group previously filed consolidated returns or if the newly formed group elects to file consolidated returns for the year of the acquisition), the acquired corporation ([redacted] shall be treated as the common parent of the group for that corporation's ([redacted]'s) entire taxable year ([redacted] and the acquiring group ([redacted] and [redacted] shall be treated as its ([redacted]'s) subsidiaries for that portion of the acquired corporation's ([redacted]'s) taxable year subsequent to the acquisition. Thus, [redacted] and [redacted], in effect, had two short taxable periods in [redacted]. The first as their own group ([redacted], through [redacted] and the second as part of the [redacted] consolidated group ([redacted] through [redacted]). However, [redacted] had only one taxable period for all of [redacted] which includes its income for all of [redacted] and such return also included the income of [redacted] and [redacted] for their period [redacted], through [redacted].

For the year following the taxable year of the acquisition, which, in this case is the year at issue ([redacted], the actual parent of the group ([redacted]) becomes the common parent for consolidated return purposes but the acquired group or newly formed group ([redacted]'s "group") is deemed to continue in existence. See Lerner, Antes, Rosen & Finkelstein, Federal Income Taxation of Corporations Filing Consolidated Returns § 5.01[3].

Thus, in this case, the affiliated group that filed a consolidated return for [redacted] is treated as the continuing group. This group is the [redacted] group consisting of [redacted] as the deemed common parent for taxable year [redacted] and as a subsidiary for the [redacted] taxable year; [redacted] as a deemed [redacted] subsidiary from [redacted], through [redacted], and as the common parent for the [redacted] taxable year; and [redacted] as a deemed subsidiary of [redacted] from [redacted] through [redacted] and as a subsidiary of [redacted] for all succeeding years in which it is a member of the group. Thus, the preceding tax years of the [redacted] group are the pertinent years.

Thus, in this case, the term "preceding taxable year" in section 6655(d)(1) refers to the [redacted] taxable year of the [redacted] group. Similarly, for the purpose of determining whether the [redacted] group was a "large corporation" within the meaning of section 6655(i), the 3 taxable years immediately preceding the year at issue ([redacted]) would be the [redacted] taxable year of the [redacted] group and the [redacted] and [redacted] taxable years of [redacted] itself.

In this context, it should be noted that an issue exists as to whether the [redacted] taxable year of the [redacted] group was a 12-month period, as required by the exception in section 6655(d)(1), in light of the fact that [redacted] and [redacted] were members of the [redacted] group for less than 12 months. We think that

because the consolidated return filed by the [redacted] group for [redacted] included a full 12-month period, even though only a full 12 months of [redacted]'s income, the literal language of section 6655(d)(1)--that the preceding year be a 12-month period--is satisfied. This conclusion is supported by the fact that under Reg. § 1.1502-5(b)(2)(ii), the tax information of members coming into the group in midyear is ignored for the purposes of sections 6655(d)(1) and (2) and only the consolidated return of the group for the preceding year is considered. See Lerner, at ¶ 4.06[3][a].

The data submitted by the taxpayer shows that for each of the 3 taxable periods preceding [redacted], the [redacted] group and [redacted] had taxable income of less than $[redacted]. Specifically, the [redacted] group reported a loss for its [redacted] taxable year of $[redacted]; [redacted] also reported a loss for its [redacted] taxable year, such loss resulting from the carryback of [redacted]'s portion of the [redacted] group's [redacted] net operating loss; and [redacted] also reported a loss for its [redacted] taxable year, such loss again resulting from the carryback of [redacted]'s portion of the [redacted] group's [redacted] net operating loss.[1] Therefore, the [redacted] group is not a large corporation for the year at issue ([redacted]). Furthermore, the data shows that for the year preceding the year at issue ([redacted]), the [redacted] group filed a return showing a tax liability even though such liability only consisted of investment tax credit recapture of $[redacted]. As stated above, the [redacted] group filed a consolidated return for [redacted] which included a full 12 months. Therefore, the [redacted] group can take advantage of the exception in section 6655(d)(1).

The data also shows that the [redacted] group made quarterly payments of estimated tax for the year at issue totalling $[redacted]--$[redacted] on [redacted], for the first quarter, nothing for the second quarter, $[redacted] on [redacted] for the third quarter, $[redacted] on [redacted]; and $[redacted] on [redacted], for the fourth quarter. As stated above, the group's tax liability for the preceding year, [redacted], was only $[redacted]. The pro rata portion of this [redacted] tax liability allocated over the four quarters in [redacted] and accommulated at the end of each quarter for all previous quarters--which amounts were the minimum estimated tax payments that the [redacted] group had to make shortly after the end of each quarter under section 6655(d)(1)--was $[redacted] for the first quarter of [redacted]; $[redacted] for the first and second quarters; $[redacted]

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[1] Prior to the 1987 amendments to section 6655, carrybacks and carryovers were taken into account in applying the "large corporation" test. See LTR 83-28-125 (April 15, 1983); LTR 84-33-027 (May 11, 1984); LTR 84-35-034 (May 24, 1984); LTR 84-37-065 (June 12, 1984).

for the first, second and third quarters; and $[redacted] for all four quarters. The estimated tax payments made with respect to the [redacted] group's [redacted] taxable year exceeded the quarterly pro rata portion of the [redacted] tax liability accumulated at the end of each quarter. Therefore, the [redacted] group falls under the exception in section 6655(d)(1) and no penalty should be assessed against it.

If you have any questions, please contact Lawrence S. Mannix at FTS 566-3470.

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